

ANNEXURE B12

HESSEQUA MUNICIPALITY



LIQUIDITY POLICY

Goedgekeur / Approved: 28 May 2015 – 3rd Review

For implementation on 1 July 2016

TABLE OF CONTENTS*Page*

| | |
|-------------------------------------|---|
| 1. Introduction | 2 |
| 2. Background and approach | 2 |
| 3. Legislative requirements | 2 |
| 4. Liquidity policy | 3 |
| 5. Corporate governance (Oversight) | 6 |
| 6. Transitional arrangement | 6 |
| 7. Policy management | 6 |
| 8. Annexure 1 | 7 |

INTRODUCTION

The documented Liquidity Policy sets out the minimum risk management measures that Hessequa Municipality has to implement and adhere to in order to ensure that its current and future liquidity position is managed in a prudent manner.

Liquidity is the amount of cash and / or “near cash” (which refers to assets or security that can easily and quickly be converted to cash), available to be utilized to meet obligations and / or pay commitments. The marketability or ability to buy or sell an asset without incurring unacceptable large losses thus determines the liquidity of an asset or defines it as near cash.

This Policy is implemented to provide guidance on the minimum liquidity level that Hessequa Municipality has to maintain in order to comply with required legislative and / or National Treasury directives and within the overall financial management objectives as approved/reviewed by the Council from time to time.

1. BACKGROUND AND APPROACH

Various policies and procedures exist that direct the way in which the business of Hessequa Municipality is or should be conducted in a prudent manner. Generally these policies and procedures flow from the prescription made in Legislation i.e. the Municipal Finance Management Act (“MFMA”) and/or directives issued by a national department such as National Treasury.

Whereas it is required for Hessequa Municipality and other municipalities to have an Investment Policy, no specific legislative requirement exists as it relates to the level of cash or near cash (broadly defined as liquidity) that needs to be held by municipalities.

Guidelines provided by National Treasury indicate that an acceptable level of cash resources needs to be available for working capital requirements (see below).

It is for this reason that the need to have an official Liquidity Policy was identified.

2. LEGISLATIVE REQUIREMENTS

National Treasury has issued guidelines for municipalities to follow in managing their liquidity requirements. The National Treasury guidelines indicate that a municipality should hold sufficient cash and near cash to cover at least 3 months of operational expenditure.

The MFMA does not specifically address the liquidity requirements and methods of quantifying same. Section 13 of the MFMA only refers to cash management and investments.

Other specific requirements exist as to earmarked reserves or provisions that need to be cash backed at all times, which also provides guidance as to the amount of cash that should be available to cover the short term liabilities / commitments of the municipality.

3. LIQUIDITY POLICY

This policy provides guidance on the determination of the minimum liquidity requirement and the calculation of the liquidity available of Hessequa Municipality from time to time (see **Annexure 1**).

Notwithstanding the requirements as reflected in this policy, Hessequa Municipality should ensure that its Current Assets (excluding debtors older than 90 days) cover all of its Current Liabilities at least one time.

The policy encapsulates certain key aspects and considerations which have been outlined below:

3.1. Key components of minimum liquidity required:

The following constitutes the key elements to take into consideration when determining the liquidity requirement of Hessequa Municipality:

- 3.1.1. To comply with statutory requirements it is proposed that the following funds, reserves and provisions be fully covered by unencumbered cash and investments:
 - 3.1.1.1. *All earmarked or conditional grant transfers from spheres of Government or from Public Contributions made to Hessequa Municipality that have not yet been utilized;*
 - 3.1.1.2. *All commitments resulting from the legally entrenched rights and benefits employees have, with specific reference to the Council's short term commitment to staff retirement benefits and medical fund claims payable;*
 - 3.1.1.3. *All funds not yet been utilized in relation to agency services provided on behalf of Provincial or National Government should also be treated as earmarked funds;*
 - 3.1.1.4. *All reserves stated by Hessequa Municipality on its Statement of Financial Position that have been established for the purposes of making provisions for a defined purpose.*

- 3.1.2. Cognisance also needs to be taken of the external loan commitments and the servicing of capital and interest on these loans. Therefore provision should be made that Hessequa Municipality can meet its external loan/financial commitments together with the normal operational expenditure, as well as its liabilities to staff.
- 3.1.3. All investments ceded as security against long term loans need to be excluded from total cash and investment balances for calculation of the minimum liquidity level required.
- 3.1.4. In addition, a level of cash available for normal operational expenditure needs to be held in cash to ensure that, notwithstanding fluctuations in the monthly income levels of Hessequa Municipality, Hessequa Municipality will be in a position to meet its financial requirements. In this respect, the average monthly operational expenditure needs to be used as a guide of the minimum buffer required. One month's operational expenditure excluding debt impairments should be available for liquidity cover.
- 3.1.5. The "golden rule" should be to ensure that Hessequa Local Municipality will have adequate liquid assets (those that can be made into cash within 24 hours, weekly or monthly as the requirement might be) to meet its short term financial commitments.

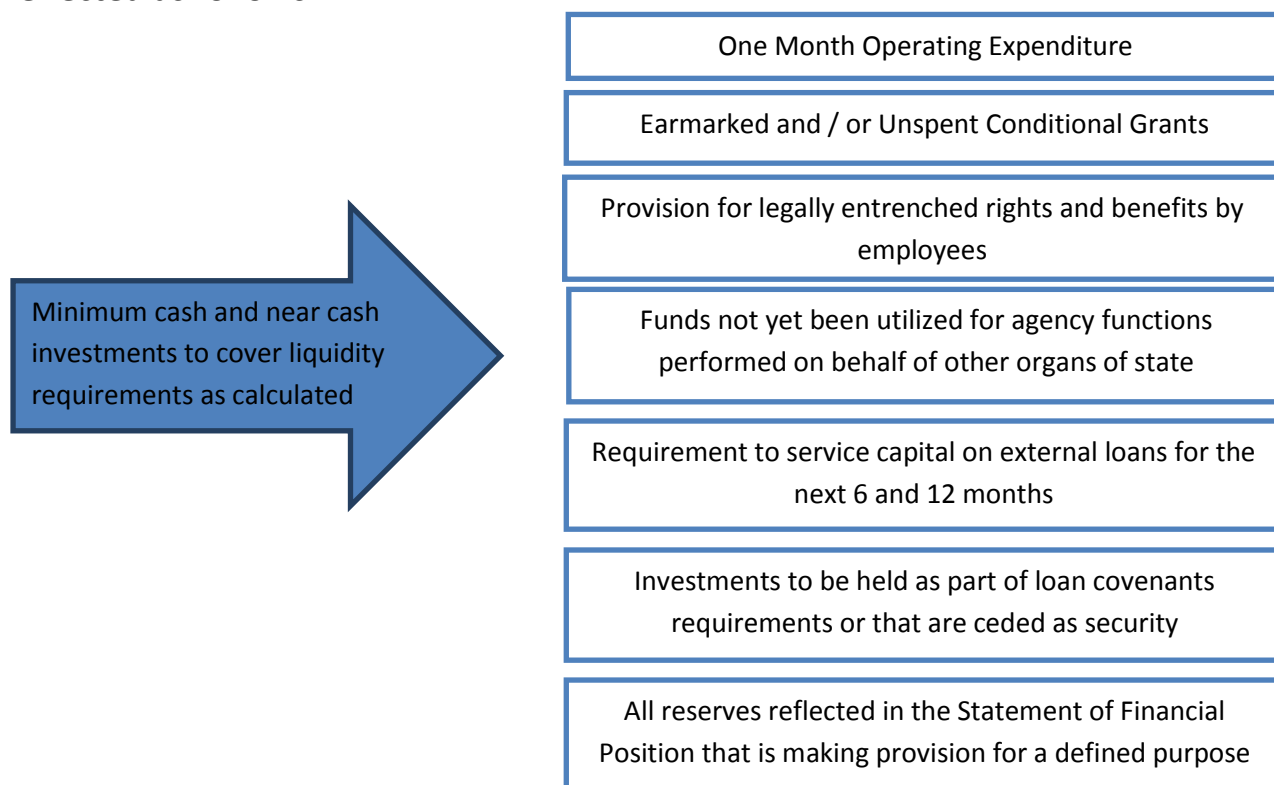
3.2. Calculation of available liquidity

The amount of liquidity available should be determined from time-to-time. The following, should be regarded as cash and or near cash in calculating the available liquidity:

- 3.2.1. *All cash held in a bank account or invested with a money market fund;*
- 3.2.2. *95% of the value of all NCD's or other tradable instruments issued by a bank that are not already ceded;*
- 3.2.3. *90% of the market value of all listed bonds on the JSE in which Hessequa Municipality is allowed to invest in;*
- 3.2.4. *100% of the budgeted monthly equitable share that needs to be paid to Hessequa Municipality by National Treasury;*
- 3.2.5. *85% of the monthly billings issued by Hessequa Municipality;*
- 3.2.6. *Amount of unspent conditional grants and public contributions excluded from own funds held in bank accounts;*
- 3.2.7. *Funds provided to Council for expenditure on activities executed on behalf of other spheres of Government (Provincial and / or National) as part of an agency function, excluded from own funds held in bank accounts;*
- 3.2.8. *The employment benefit reserve fund resulting from medical and / or retirement benefits for staff, not included in bank balance (e.g. invested by independent investment managers);*

- 3.2.9. *Cash amounts that need to be held by Council resulting from loan covenants' that are part of the conditions of loans extended, but not ceded outright to lenders;*
- 3.2.10. *The undrawn portion of unconditional bank overdraft facility or liquidity facility available to Hessequa Municipality.*

The aforementioned in paragraphs 4.1. and 4.2. can schematically be reflected as follows:



3.3. Implementation and monitoring of compliance with liquidity policy:

Once the policy is approved, the CFO is to be tasked to ensure that the required cash has been built-up to meet the requirements as set out in this policy.

Firstly, the minimum required liquidity level should be calculated based on audited annual financial statements. This level of liquidity required needs to be specifically budgeted for and as a minimum on a quarterly basis reported on to the Finance Committee and / or other Committees as might be stipulated by Council as well as to Council.

Notwithstanding National Treasury's three months operational expenditure guideline and the one month operational expenditure buffer proposed as a minimum by the liquidity policy, it is recommended that Council set a target of two month's operational expenditure liquidity buffer to be achieved at the end of the transitional period (reference paragraph 6). The cash provisions made to repay external loan commitments, if specifically earmarked, should also be added to this minimum working capital liquidity, to prevent fluctuations in

the working capital reserve that could put the minimum level of liquidity levels under pressure.

4. CORPORATE GOVERNANCE (OVERSIGHT)

The minimum liquidity requirements must be determined for the next financial year should on an annual basis at the current financial year end by the Chief Financial Officer and reported to the Municipal Manager.

Compliance with this policy will be monitored by the Chief Financial Officer. The Chief Financial Officer must present the liquidity compliance reports to the Finance Committee and the Audit Committee of the municipality.

Where compliance has been breached the Chief Financial Officer must present an action plan to correct the non-compliance. The Finance Committee must monitor the successful implementation of the corrective action plans and report progress to Council.

5. TRANSITIONAL ARRANGEMENT

Upon adoption of this policy by the Council, the Municipal Manager in conjunction with the Chief Financial Officer must determine the current liquidity levels of Hessequa Municipality against this policy and present a plan of action towards achieving the minimum liquidity levels set out in this policy.

The Council must approve an appropriate timeframe within which Hessequa Municipality must achieve the approved minimum liquidity levels set out in this policy. The period between the date of the policy adoption by Council and the target date for compliance shall be known as the Transitional Period.

The Finance Committee must report progress during the approved transitional period to the Council.

6. POLICY MANAGEMENT

The Liquidity Policy forms part of Hessequa Municipality overall financial objectives and therefore forms part of approved Budget Policies. The policy must be reviewed at least annually during the budget revision and presented to Council for approval. The policy is effective from the date it is approved by Council.

ANNEXURE 1

Liquidity Requirement as per Liquidity Policy

Date: _____

Liquidity Requirement Calculation [as stipulated in Paragraph 4.1.]**Inputs**

- All earmarked and/or conditional grants received but not yet utilised
- Value of legally entrenched rights and benefits of employees related to:
 - Medical benefits
 - Retirement benefits
- Funds held for agency services not yet performed
- Reserve funds reflected in Statement of Financial Position that are assumed to be held in cash
- Capital redemption and interest payments on external loans not reflected as part of normal operational expenditure
- Budgeted operational expenditure excluding non-cash items
- Commitments resulting from contracts concluded as part of Capex Programme, not reflected in operational budget

6 months**12 months**

| | |
|--|--|
| | |
| | |
| | |
| | |
| | |
| | |
| | |

TOTAL LIQUIDITY REQUIREMENT

Actual available liquidity held [reference paragraph 4.2.]

| | 6 months | 12 months |
|---|----------|-----------|
| • Bank Balance at: | | |
| - ABSA | | |
| - FNB | | |
| - Standard Bank | | |
| - Nedbank | | |
| - Investec | | |
| - Investments in Money Market fund | | |
| Bank balance sub total | | |
| • 95% of all other term investments with Banks | | |
| • 90% of Market value of all Bonds on the JSE that are held | | |
| • 100% of monthly equitable share | | |
| • 85% of average monthly billings | | |
| • Other reserves held in cash not reflected in bank balances mentioned above: | | |
| - Unspent conditional grants | | |
| - Payments received for agency functions not yet performed | | |
| - The cash value of the employment benefit reserve fund related to: | | |
| ○ Medical benefits | | |
| ○ Retirement benefits | | |
| - Cash deposits held as part of loan covenants or ceded | | |
| - Undrawn bank overdraft facility or committed liquidity lines available from banks | | |
| TOTAL LIQUIDITY AVAILABLE | | |
| LIQUIDITY SURPLUS (SHORT FALL) | | |
| Liquidity ratio: | | |
| Current Asset/Current Liabilities | | |